Greenhouse and competitiveness

EcoCarbon

economic growth with emissions trading

A scoping paper prepared with the assistance of LateraEconomics

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1 Introduction

The intensifying concern over global greenhouse gas emissions has raised difficult issues for Australia. The policy issues raised involve considerable difficulties for Australia for two reasons.

- It is a relatively energy intensive economy which is a major exporter of fossil fuels such as oil and gas and of goods which embody substantial energy consumed in their manufacture such as steel and aluminium.
- It exists in a region of countries which are capable of producing some of the energy intensive products Australia now exports, but which will not be subject to binding emissions reductions targets for some time.

This paper seeks to tease out some of the critical policy issues for Australia. It does not seek to argue any case, or come to any conclusion on any of the possibilities discussed. Rather the format is to explore the advantages and disadvantages of each proposal considered to guide further discussion, research and policy development.

The policy options are considered under three categories. The first – 'Emissions Trading Options' explores domestic or unilateral options and then international options. The latter options are discussed with an eye to what the Australian government, and other Australian players might do to influence policy outcomes at the international level. Often the distinction between domestic and international policy measures can be somewhat arbitrary as domestic and international options are often two sides of the one coin.

The second category is 'Direct Government Assistance and Tax Measures' including direct assistance funded by government, and alternative means of subsidising certain activities – for instance tariffs and/or administrative targets etc. The final category is 'Facilitative Measures' in which governments seek to facilitate learning both by their own agencies and amongst firms. Such measures typically have a positive, but relatively small cost to government.

2 Emissions trading options

2.1 Domestic Policy Measures

2.1.1 IMPLEMENT DOMESTIC EMISSIONS TRADING.

Although other policies may be a useful adjunct, it is unlikely that any substantial emissions abatement can take place without flexible market based instruments. Domestic and international emissions trading are the front runners for such action. Although a carbon tax is also a possibility, an emissions trading regime with short term emission entitlements auctioned or sold by government, amounts to much the same thing. Accordingly, the idea of a carbon tax is encompassed in a sufficiently broad ranging discussion of emissions trading options. This is intended in this paper.

If we assume a need to lower emissions either domestically or internationally, emissions trading is likely to be the lowest cost means of doing so. Firms with the lowest cost of abatement will lead abatement, whilst those with the highest marginal costs of abatement will only be able to expand their emissions by purchasing other firms' excess permits – in effect funding additional abatement from low cost abatement firms. These decisions will be made by individual companies, thus avoiding the necessity for government to 'second guess' markets and technologies.

The other side of this coin is of course that firms with a high marginal cost of abatement will become substantially less competitive. There are two issues here. With comprehensive coverage of countries within an international regime, the structural adjustment which would take place within Australia would be the **most efficient** kind of adjustment which would need to take place **globally** to meet greenhouse emissions abatement objectives.

On the other hand, where, as is likely, large developing countries are exempted from binding undertakings for some time, a substantial amount of the structural adjustment in Australia would generate 'carbon leakage' – investment in carbon emissions in other countries. The result is economic losses in Australia, with the environmental benefits from lower Australian emissions diluted, outweighed, or even wholly negated by consequential emissions elsewhere.

2.1.1.1 The timing of Australian emissions trading

As asserted above, co-ordinated international action will be necessary if substantial global abatement is to take place.

The advantages of Australia's moving early are:

- Australia has very limited 'negotiating' coin in the international community on account of its size. Nevertheless we may be able to have much more influence on the world by setting an example. In particular, if Australia implemented an administratively simple and efficient carbon trading system, its 'demonstration value' to the rest of the world could be much greater than any negotiating value the threat of being a laggard would have.
- We would be seen to be an environmental leader internationally
- It would encourage Australian firms to become international leaders in the development of carbon abatement business models, capabilities and technologies.

Disadvantages of early moving:

- Australia is in a very precarious position both with regard to its carbon intensity, and its regional exposure to 'carbon leakage'. Early moving could undermine our international negotiating capacity to receive consideration for these special circumstances.
- Early moving could help the Protocol come into force. If Australia considers that the Protocol is unworkable or unfairly discriminatory against us, then we should not promote its adoption.
- International business leadership in the development of carbon abatement business capabilities and technologies would involve costs. It is possible that these costs would not be outweighed by benefits. This would occur if, for instance, the value of those capabilities is undermined by subsequent scientific developments which conclude that increased greenhouse gas concentration in our atmosphere is not of serious concern.

2.1.1.2 Pre-emptive design of an emissions trading system

It would be possible to foreshadow all the design elements of a domestic emissions trading scheme well in advance of its implementation. Already the Australian government has committed a small fraction of the pool of carbon credits it has available to recognising early action. It would be possible to implement an emissions trading scheme without any immediate domestic emissions limitations. Thus the rules of trading and allocation could be fully specified, awaiting some event to bring the scheme into existence.

It would even be possible to allocate permits as the permits would have no immediate value until the government required them to be acquitted against actual emissions. Indeed, this is

essentially what is involved in the Government's new scheme recognising early action. Permits could then be traded based on their contingent value if they were ever required for emissions.

Advantages

- Firms are already seeking to manage 'carbon risk'. 'Virtual emissions trading' would enable them to manage their risk very effectively. Companies with high risk tolerances could sell permits to companies which require a high level of carbon security – for instance those seeking to fund new investments.
- Firms would gain advance knowledge of the mechanics and commercial fundamentals of trading. Trading technologies could be developed by clearing houses giving them a potential advantage as the international carbon market developed.

Disadvantages

- A great deal of corporate and government administrative learning effort would be required, which might ultimately be of little use if trading did not go ahead in the form that the 'virtual trading' system adopted.
- The adoption of a 'virtual trading' system could create circumstances where pressure was brought to bear on Australia to implement the system it had designed ahead of others.

2.1.1.3 Selective exemption from trading.

It would be possible to give certain sectors favourable treatment under trading or a carbon charge by either exempting them from the requirement to pay the charge or hold permits matching their emissions or by treating them concessionally in some way. The LNG Action Agenda calls for such a policy to facilitate greater gas exports to the region to lower global greenhouse gas emissions. Likewise other sectors have sought arrangements to ensure their continued prosperity in Australia.

Advantages:

- Where the structural adjustment involved would generate large adjustment costs, those adjustment costs could be reduced.
- Where the increased emissions of a sector would make a net contribution to reducing greenhouse gasses globally – as for instance in the case of the export of North West Shelf gas – preferential treatment could be expected to enhance global economic and environmental welfare.
- Moreover Australian gas exports in the region are frequently competing with more greenhouse intensive fossil fuels in non-annex 1 countries. This places the more greenhouse friendly option at a further disadvantage in the region.
- It could be argued that having got a larger 'assigned amount' at Kyoto, some of that international 'generosity' could appropriately be returned by Australia in the form of a 'self denying ordinance'. Under such an approach Australia would somewhat compromise the economic efficiency of its allocation of emissions permits from its own economic perspective, in order to move closer to the best international economic and environmental outcome possible. To some extent it would take lessening 'carbon leakage' upon itself, at a cost to its own economic efficiency, on the grounds that it argued it needed a higher assigned amount at Kyoto to offset the risk of higher carbon leakage.

- Favourable treatment could be made conditional on carbon abatement and/or CDM/JI undertakings of favoured sectors.

Disadvantages:

- The measure fundamentally seeks to avoid the structural adjustment which is implied in a world of carbon scarcity. It is like giving special 'adjustment' quotas to rice growers when there is a drought. Accordingly, where additional permits are given to one industry, fewer must be given to others – otherwise the constraint is not met and one is neither meeting one's target nor implementing a bona fide carbon trading regime. As a consequence, a different kind of structural adjustment takes place. There are similar losses – only they are made by industries which are not given favourable treatment by the regime. However, in addition to the (shifted) costs, the total costs of carbon abatement are higher across the economy. This is because carbon abatement has been shifted to sectors which could otherwise have emitted more.
- The measure compensates disadvantaged firms, not people, and so would attract opposition – both at the political level and within the central economic advisory agencies in Canberra.
- Selection of who to discriminate in favour of – and so of who to discriminate against – would be fraught with political and practical difficulty and so also uncertainty.
- Special favours to industry could undermine political commitment to household abatement.
- Favoured sectors lose the market incentive to improve their carbon efficiency. This lowers both their carbon efficiency and their capacity to anticipate what may be increasing carbon scarcity. This would also be true of domestic consumption if favourable treatment extended to all production including production for the domestic market.

2.1.1.4 The duration of permits and their status as entitlements

The purpose of setting up a trading system is ultimately to establish a carbon price within the economy which will ensure that the negative 'externality' of carbon emissions is 'internalised' in the decisions of firms. Rights to emit – permits – can be considered as licences or as property rights. If a government revokes a licence – for instance a drivers licence – there is generally no automatic right to compensation. By contrast removal of a property right is subject to constitutionally entrenched rights to compensation.

A conjoint issue is the length of time for which permits run. The confiscation of a one year permit is clearly of much greater economic and legal significance than the confiscation of an emissions permit issued in perpetuity.

Both issues relating of tenure and property rights are essentially about risk taking – the extent to which various risks are taken by government, and the extent to which they are taken by permit holders and investors in emissions intensive production.

Often licences designed to ration scarce resources are issued in perpetuity with a secondary market developing that trades the asset. Examples exist in the areas of taxi 'plates', fish and water quotas and (before they were abolished) import quotas. Some – such McKibbin and Wilcoxen and consultants ACIL – argue that this is what should be done in the case of emission entitlements. The alternatives are much shorter-lived permits – for instance as short as one year. A compromise would be a mix of permits with different tenures.

It is also worth noting that there are ways for governments to share risk with permit holders at the same time as providing them with very well defined and long lived property rights. Thus for instance, the right to emit could be expressed as a percentage of Australia's target at any given

time. Here governments would bear the risk of any confiscation of holders' permits, but the holders would bear the risk of any change in Australia's 'assigned amount' in subsequent rounds of international negotiation.

Precedents for such risk sharing exist already where economic instruments have been used to regulate environmental outcomes. Thus for instance water quotas and fish quotas are often expressed as a percentage of a given amount which is determined taking into account environmental circumstances during specific periods.

Although they are related, the two issues of property rights versus licences, and long versus short duration permits are easily distinguished conceptually and for this reason are here explored separately.

Advantages of property rights:

- Full property rights encourage confidence in the underlying asset of the permit. This will improve the confidence with which traders can trade the asset, and so the integrity and liquidity of the market. It will improve the confidence with which people can invest in carbon emitting projects thus enabling Australia to meet any target it sets itself in as efficient a way as possible.

Disadvantages of licences:

- Government may need to change its plans, and will wish to avoid bearing all the risk of needing to do so.
- Some object in principle to property rights to pollute.

Advantages of long lived permits are:

- They allow firms to plan and invest.
- They allow a fuller market to develop in the time preference of emissions permits than could exist with shorter lived permits. Thus owners of permits can enter into contracts to lease them for any period of time, for specific projects or to speculators.
- If government renegotiates its target, it will fully build in the cost to Australia of such a course of action because it will have to raise the money to buy back the permits on the open market. (This assumes that permit holders will successfully assert some rights to recompense whether or not the permits are treated as property).

Disadvantages of long lived permits are:

- If permits are used to raise revenue, this happens once only. Moreover if permits were auctioned, uncertainty would tend to drive down the returns from auctioning – lowering the efficiency of the auction as a revenue raising device.
- The government faces large risks. If it renegotiates targets it may find it very difficult to buy back the permits on issue (subject to the clarifications offered in the following subsection). One could argue that it is more efficient for such a large risk to be shared throughout the economy, not just imposed on Government.

2.1.1.5 Managing structural adjustment

One could provide assistance to sectors worst hit by emissions trading. Revenue from a carbon tax or auctioned permits could be 'recycled' back to industries that are most hurt by the tax or trading regime whilst maintaining some incentives to abate carbon at the margin.

Advantages:

- Could offer a way of reducing the burden on specific industries, whilst leaving them with some incentive to abate carbon at the margin.
- Would not be inconsistent with our international obligations
- The USA has provided tax credits for the production of more environmentally friendly fuel products from coal and this has been tested to be consistent with WTO principles. This approach provides an armory of measures that can reduce the impact of mandated abatement on competitiveness.

Disadvantages:

- Recycling revenue back to firms which are paying it due to their carbon intensity undoes the work of the initial policy. Whether it does so in whole or in part depends upon the design of the system. At the very least, if the scheme operated as ongoing assistance it would interfere with the inter-industry part of the adjustment to carbon scarcity. That is, the carbon intensive industries would be overly large under this model of adjustment, throwing the burden of adjustment onto industries with lower costs of abatement. This situation is inherently inefficient. However, such a scheme could be designed to allow the incentive to abate carbon to survive within firms as they considered the appropriate technologies for their operations.
- Complexity, political contention and uncertainty would arise under this option.

2.1.1.6 Tariff and other 'cross border' issues

Australia has run an aggressive trade liberalisation program since the late 1980s. However, some of its tariffs are not 'bound' within the WTO architecture to levels as low as they are actually set. This leaves open the possibility of freezing some tariffs in energy intensive areas and/or increasing them in other areas – particularly where any loss of competitiveness is generated by 'leakage' of carbon intensive investment to countries without commitments.

Advantages:

- Tariffs are a well-established and understood policy in Australia.
- They offer a means of assistance that, rather than being a drain on government revenue, is generally a contributor to revenue.
- Part of the cost of the measures would be borne by the countries we were trying to persuade to take on binding commitments under the UNFCCC.
- This approach and possible variants of it are given greater contemporary relevance by recent calls to include environmental considerations in WTO trading rules.

Disadvantages:

- Only protects domestic production bound for domestic market. Our industries with high marginal costs of abatement are mostly also export intensive – for instance iron and steel, non-ferrous metals, LNG, coal, agricultural commodities. (Exceptions include cement, fertilisers and petrochemicals including plastics.)
- It is indiscriminate. Under WTO rules we would be required to impose the same tariff on all countries, despite the fact that the only countries of concern would be non-Annex 1

countries. The policy is thus doubly inefficient. It excludes exports from Australia, and hits too many imports to Australia.

- The above two points illustrate the way in which the policy draws greenhouse policy into trade policy and in so doing renders each less coherent.
- Would invite retaliation – against the very export intensive sectors we are concerned about, *and* from the Annex 1 countries the WTO arrangements force us to penalise.
- Increases costs within the Australian economy, reducing competitiveness.

2.2 International Policy Measures

There is a good chance that the Kyoto Protocol will not come into force. The most immediate cause of this is the American administration's recent indication that it did not intend to ratify the convention. More generally, virtually all Annex 1 countries have failed to impose the degree of constraint on their carbon emissions that would achieve the Kyoto target.

In these circumstances, consideration of the kind of international regime we are building is especially appropriate.

2.2.1 ALTERNATIVE APPROACHES TO KYOTO

The Kyoto architecture focused on delivering a specific targeted reduction in greenhouse gas emissions. An alternative policy – advocated by Australian economist Warwick McKibbin – is for countries to jointly agree on the price of carbon emissions.[1]

Broadly, McKibbin and Wilcoxen propose that there be no carbon trading and that each country impose upon its producers a carbon tax of an internationally agreed figure at the margin of production. Thus McKibbin and Wilcoxen propose that in each participating country a certain level of emissions be embodied in perpetual emissions permits – these could be allocated as countries saw fit – with additional emissions being taxed at an agreed amount. McKibbin and Wilcoxen provide US$10 per ton of carbon as a reasonable starting price. This price would then establish the opportunity cost of both carbon emissions and carbon abatement across participating economies. It would not require carbon trading between countries to equalise the carbon abatement price across participating countries.

Advantages:

- It is much easier to estimate the cost to a country (or group of countries) of imposing any given carbon price, than it is to estimate the cost of meeting a given quantity target.
- The estimate of cost will involve substantially lower estimation errors than the alternative of a quantity target.
- Globally harmonised marginal carbon taxes as proposed by McKibbin and Wilcoxen deliver most of the benefits of carbon trading (equalising the marginal cost of abatement across economies) without the transactional costs and disruption to international monetary flows associated with international emissions trading.
- Generates revenue for government from an environmental 'rent'. Such revenue raising is economically very efficient. Most tax depresses desirable economic activity whereas environmental taxation raises revenue by depressing undesirable activity. Other things being equal – and disregarding any benefits derived from spending the revenue raised – most tax depresses economic welfare. Well designed environmental taxation improves economic welfare – even before the revenue which it raises has been spent.

[1] There would be more than one way of establishing an international regime targeting the marginal cost rather than quantity of emissions. The advantages and disadvantages explored here are probably relevant to many such schemes. Nevertheless the 'model' which is addressed specifically in these comments is that of McKibbin and Wilcoxen. Further details of the model can be found at www.msgpl.com.au.

Disadvantages:

- The public are less impressed by a commitment to something as abstract as a given carbon price than they are to a commitment to reduce carbon emissions by a given amount.
- Does not offer as much scope to 'bribe' countries into the system by providing them with excess permits over what they will need. (Russia for instance, was 'bribed' into the Kyoto undertakings with a larger assigned amount than it needed).
- Although it can reduce destabilising capital flows, those flows may actually be necessary to ensure the lowest cost abatement activities are funded.
- Can be ineffective where the optimal outcome would be for a country to dramatically lower its emissions to allow others to expand.

2.2.2 THE PROBLEM OF EMBODIED CARBON

Australia is unique amongst the Annex 1 countries in being a major exporter of goods such as LNG, Steel and aluminium and magnesium in which substantial emissions are embodied in production. The ultimate beneficiaries of the emissions involved in the production of these goods are consumers in the countries to which they are exported. Accordingly Australian interests could be well served by negotiating a more 'exporter friendly' international regime in which – at least for some energy intensive products – emissions accrue to the country that ultimately benefits from the production – the importer rather than to the producer and exporter of the production.

Advantages:

- For as long as a substantial number of countries avoid binding commitments, imposing obligations according to emissions *consumed* rather than emissions *produced* will generate more efficient outcomes in a range of areas where it lowers carbon leakage.
- Allows Australia to play one of its most important environmental roles in the region – that of an exporter of LNG which will facilitate carbon abatement within the region including in non-Annex 1 countries, even though it is at the cost of increased emissions in Australia.
- Fits Australia's circumstances well as an exporter of products with substantial embodied energy.
- Removes a distortion in Australia that obstructs investment in value adding.

Disadvantages:

- Japan and other energy importers – particularly many European countries – would oppose it.
- Re-opens issues which most other countries regard as already settled. Accordingly placing this high on our list of international negotiation priorities could be a poor strategic choice. Australia will continue to be in need of specific consideration of its unique circumstances from time to time in climate change negotiations. Accordingly we should 'keep our powder dry' unless we have a lot to gain and a good chance of success.
- A pure system of charging for carbon emissions at the level of consumption would become horrendously complex. Accordingly it would be necessary to limit the 'consumption' approach to a sub-set of carbon intensive activities, and it would be necessary to produce 'rules of thumb' to track the emissions through to their final consumption.

- Given this, JI is the instrument to address the production/consumption dilemma concerning the North West Shelf – at least regarding exports to Annex 1 countries such as Japan – not consumption based carbon cost accounting.
- The issue of choosing between internalising costs at the consumption stage rather than the production stage is ultimately a transitional one. Once all countries are in the net, the international price mechanism removes most, if not all, of the discriminatory nature of the current system. At this point the simplicity of internalising where the emissions actually take place demonstrates its superiority.
- Though some of our exporters would benefit, Australia is also an importer of embodied energy and at least these sectors of the Australian economy would lose out under the new rules.

2.2.3 EXPANDING KYOTO TO THE NON-ANNEX 1 COUNTRIES.

2.2.3.1 Sanctions and commitments.

Developing countries have had at least a decade of notice about the importance of greenhouse gas emissions. Should there be strong sanctions for countries refusing to take on binding commitments?

Advantages:

- Would generate substantial incentives for non-Annex 1 countries to come into the agreement with binding commitments where currently, all the incentives are to avoid binding commitments for as long as possible.

Disadvantages:

- Would be a very substantial shift towards coercion of UNFCCC members. This would be bitterly resisted by non-Annex 1 countries, and possibly other Annex 1 countries who would wish to avoid sanctions;
- Could be used against Australia if it sought to stand outside an emerging system for any length of time.
- Could make adherence without ratification – one possible option available to Australia and other countries – more problematic.

2.2.3.2 Trade based sanctions

It would be possible in principle to negotiate an international regime to enable 'carbon tariffs' to be levied on goods from non-Annex 1 countries (upon entry to Annex 1 countries). This would be in proportion to the carbon emissions in the goods' production that had been exempt from a carbon charge in their country of production.

Advantages:

- Would reduce carbon leakage and so, in principle, improve (or be capable of improving) economic efficiency both:
    - Nationally and

- Globally;[2]

- Would eliminate much of the incentive for non-Annex 1 countries to hold back from making binding commitments. (Indeed, by agreeing to make binding commitments, non-Annex 1 countries would, in effect, be agreeing to impose carbon tariffs on their own goods rather than allow foreign governments to do so. The logic of doing so is the same logic which drove the Japanese to accept 'voluntary' export restraint in the automotive industry in the 1970s and 1980s. Their imposition of quantity restraint on themselves, meant that they could keep the scarcity rent that would otherwise have been collected in the importing country.)

Disadvantages:

- See first two 'disadvantages' of previous option.
- Could restrict Australia's freedom to impose unilateral border adjustments consistent with its current WTO undertakings.
- Could reduce the carbon abatement effort of our most carbon intensive sectors below the optimal amount – thus imposing greater pressure on other sectors.
- Complexity, compliance and enforcement costs, political contention and thus uncertainty in deciding what goods are in (and from where) and what goods are out.
- From a national perspective, the most economically efficient thing for us to do is 'take the world as we find it'. Accordingly, 'carbon tariffs' can assist our carbon intensive industries – though very inefficiently as assistance only occurs in the domestic market. They do so however, by imposing additional burdens on other industries, thus imposing greater total costs on the Australian economy than the benefits it confers on emissions intensive production.

2.2.3.3 Expanding CDM

Australia has substantial LNG exports and can expand production considerably. It could also become an important regional exporter of greenhouse gas abatement technology. Accordingly, it may be worth considering direct incentives to adopt such technologies and fuels in non-annex 1 countries. This could be done within existing institutions – notably the CDM – but may require a more liberal CDM than is currently envisaged by some UNFCCC participants. For instance, envisaged restrictions on technologies and technology transfer might need to be relaxed to attract the optimal level of investment.

Advantages:

- Offers another potential way of addressing the inefficiency of imposing carbon costs on projects like the North West Shelf when they will be net global abaters of emissions.
- Could help develop Australia's greenhouse gas abatement technologies to the benefit of Australia, the region and the global climate.
- Assisting greenhouse abatement technology would be well supported politically.

Disadvantages:

[2] National economic efficiency could only be improved with a multilateral system. It is must act unilaterally, it will generally be to a small country's greatest advantage to 'take the world as it is' however distorted or unfair it is, rather than try to compensate for distortions elsewhere.

- Much of the scope for this is already implicit in the Clean Development Mechanism.
- Accordingly it is unlikely that other countries will welcome the proposal which suits Australia's needs far better than the needs of most other countries.
- Countries opposing the ideas would argue that Australia's target already generously accommodates such concerns and that, accordingly, Australia's seeking out of additional favourable consideration is 'double dipping'
- The above argument leads to the conclusion that renegotiation for more favourable treatment for abatement exports could re-open negotiations on our original target.
- Could add to complexity and political contention.

3 Direct Government Assistance and Tax Measures

3.1.1 FOREIGN AID, THE CDM AND GREENHOUSE

Australia could direct more funding towards Australian firms seeking to operate within the CDM including by increasing direct government aid for abatement in countries in our region.

Advantages:

- Australian experience with the process of "prospecting" for CDM opportunities is needed to compete with an increasingly vigorous marketplace for CDM investment, even in advance of the rules being finalised.
- Other countries are providing their aid in such a form. This helps Australian companies compete with those from foreign countries increasing Australian exports.
- Some funding may be able to be diverted from other Australian aid projects.
- Establishes Australia's regional engagement with the issue and subsequently would:
    - place more effective pressure on countries in the region to take on binding commitments and;
    - influence the development of the rules under which the CDM will operate.
- These considerations suggest that CDM 'prospecting' is both high risk and will carry substantial positive 'externalities' in the form of 'learning by doing' (and influencing by doing and learning).. This will accrue to firms other than those engaged in the initial 'prospecting', learning, doing and influencing.
- CDM projects funded from Australia will generate new export opportunities and investment within Australia.
- Engagement of the developing world in the international mechanisms assists the development of a truly global agreement.

Disadvantages:

- Any additional fiscal cost
- Risk shared by the Commonwealth generates potential downside, with Commonwealth not necessarily well placed to assess commercial risk.
- Could signal a sympathy for ratification of the Protocol undermining Australia's negotiating stance.
- Official encouragement for investment in potential CDM projects could leave the Government exposed to claims of liability in the event that these projects failed to achieve a recognition as Kyoto compliant investments.

3.1.2 EXPLOITING SYNERGIES BETWEEN THER GOVERNMENT PROGRAMS AND GREENHOUSE OBJECTIVES.

Governments fund a range of projects with a range of objectives. Many contribute to greenhouse abatement and so the scope arises for securing greater funding for greenhouse gas abatement by ensuring that abatement benefits are fully taken into account when they are ancillary benefits of other worthwhile initiatives – such as improving bio-diversity.

Advantages:

- Could generate better value for government environmental expenditure, with greater funding going to projects with greater (multiple) benefits.
- Integrates government policy better. It considers the biodiversity benefits of greenhouse gas abatement projects *and* the greenhouse gas abatement benefits of biodiversity projects.

Disadvantages:

- Greenhouse gas abatement has already received substantial funding as a result of a range of initiatives including some negotiated with the passage of the tax reform legislation. It may well be the case that any 'integration' of greenhouse funding with other environmental funding would see funds flow from greenhouse to other environmental priorities.

4 Facilitative Policy

4.1.1 BILATERAL ENGAGEMENT WITH OTHER COUNTRIES.

We could explore the scope for bilateral intergovernmental agreements between Australia and other countries to facilitate foreign direct investment in carbon abatement including through the CDM and JI mechanisms.

Advantages:

- Could facilitate the identification and realisation of low cost abatement opportunities.
- Greatly enhance certainty of investments and policy operating in participating countries.
- Demonstrates engagement and pro-active approach to carbon abatement which could spillover into favourable influences on the development of the international carbon abatement and trading regime.
- Benefits of early moving on flexibility mechanisms as identified in Section One.

Disadvantages:

- In promoting this as a bilateral issue with other governments, other priorities are relatively downgraded.
- With substantial government to government involvement, non-commercial issues could come to be involved in abatement projects.
- Some (small) financial costs in the diplomatic and bureaucratic effort.
- Selection of partners would need to be skilful.
- Could introduce development aid issues into CDM projects which would further constrain them and take them away from a commercial focus.
- Other disadvantages associated with option 2.1.1 above.

4.1.2 PROMOTE BILATERAL EXCHANGE BETWEEN ABATERS AND EMITTERS

Governments could seek to explore means by which emissions-intensive producers could partner with net abators to offer products with no net greenhouse impact on the world market.

Advantages:

- May accelerate necessary partnerships between net emitters and abaters.

- May assist in marketing Australia and Australian products as ‘clean and green’.
- May be substantial ‘marketing externalities’ in establishing a brand signifying ‘no-net greenhouse impact’ of the same kind that justify the Export Market Development Grants. First movers will incur substantial marketing costs which are then captured by followers.
- Maintains Australian control of offset activity and maximises value added. Indeed, this takes ‘value adding’ in a whole new direction that may be well suited to Australia’s commodity composition of trade and comparative advantage.
- Could be a useful ‘insurance policy’ against an international greenhouse regime that has a low tolerance for international emissions trading.

Disadvantages:

- Any such program would involve a fiscal cost to government – though perhaps a relatively small one.
- If this is worth doing, there are few impediments to the market doing it on its own.
- There are few reasons for preferring Australian sources of abatement to offshore ones – which are closer to our customers for many of our emissions intensive goods production.